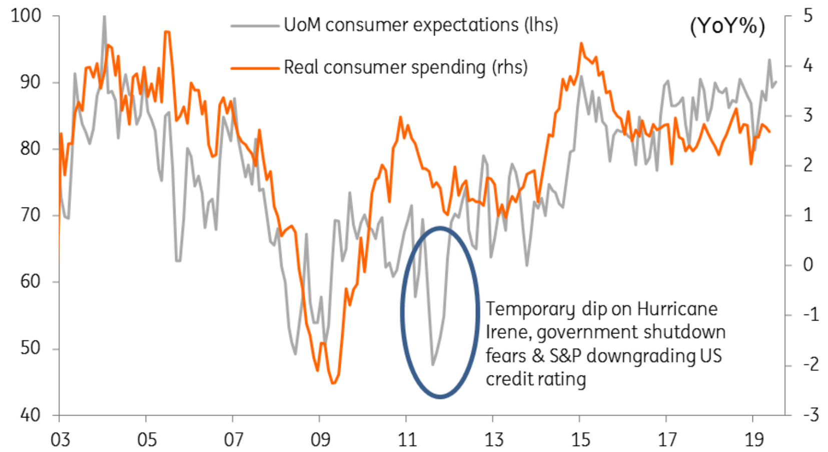
US: Confidence signals an appetite to spend

Households have the cash and the confidence to spend, limiting the need for aggressive interest rate cuts from the Federal Reserve

Consumer spending to accelerate?

The July University of Michigan consumer confidence index has come in broadly in line with expectations at 98.4 versus 98.2 in June. It remains close to cycle highs with the details showing there was a slight drop in the “current conditions” component, but the “expectations” index actually rose to 90.1 from 89.3. This is good news in that it has a decent correlation with consumer spending with the chart below hinting at a possible acceleration in consumer spending growth in the coming months.

Confidence indicators point to stronger spending growth



Source: Macrobond, ING

3Q starts on a decent footing

This report offers more evidence that the US consumer appears to be in excellent shape. Unemployment is close to 50-year lows, pay and benefit packages are improving, gasoline prices are low and equity and house prices keep on rising. As such households have cash in their pockets and the confidence to go and spend it. This was clearly evident in this week's retail sales numbers along with the fact that mortgage applications for home purchases are so strong.

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It isn't just the consumer sector that is looking in good health. While next Friday's 2Q GDP report looks set to show growth below 2% (largely an inventory unwind), the sharp rebound in the July Empire and Philly Fed manufacturing surveys, coupled with strong consumer confidence, means the outlook for 3Q19 GDP growth is encouraging.

But markets want rate cuts...

Nonetheless, worries about the prospects for US-China and US-EU trade relations are never from the market's mind. There clearly is the threat that a re-escalation of tensions derails the global growth story, which could force the Federal Reserve to aggressively cut interest rates. The Fed appears to be acquiescing by indicating a desire to implement precautionary stimulus to offset these risks.

We continue to look for just a 25bp move given the encouraging growth backdrop

The market continues to price four 25bp rate cuts over the next eighteen months with a 50-50 chance the Fed eases by 50bp on July 31st. We continue to look for just a 25bp move given the encouraging growth backdrop and the fact trade talks are continuing leaves open the door for a deal. Moreover, with the notably dovish St Louis Fed President James Bullard again today suggesting a 25bp move would be appropriate we would need to see some very poor macro/trade headlines over the next two weeks to justify more aggressive stimulus.

Author

James Knightley
Chief International Economist
james.knightley@ing.com

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